

CRS Report for Congress

WTO Compliance Status of the Conservation Security Program (CSP) and the Conservation Reserve Program (CRP)

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WTO Compliance Status of the Conservation Security Program (CSP) and the Conservation Reserve Program (CRP)

Summary

Under the auspices of the Uruguay Round's Agreement on Agriculture (AA), members of the World Trade Organization (WTO) agreed to limit and reduce their most distortive domestic support subsidies. Several types of domestic subsidies were identified as causing minimal distortion to agricultural production and trade, as identified in Annex II (the so-called Green Box) of the AA, and were provided exemption from WTO disciplines. Potential "Green Box" policies include outlays for conservation activities such as the Conservation Security Program and long-term land retirement programs such as the Conservation Reserve Program. Yet, certain aspects of both programs potentially are ambiguous or fall into "gray" zones concerning their compliance with WTO rules. This report is not a legal opinion, but describes both the CSP and CRP programs, the WTO Annex II provisions that govern compliance, and the potential issues involved in evaluating the compliance status of the two programs.

The Conservation Security Program (CSP) makes payments to participating landowners who advance conservation and improvement of natural resources on tribal and private working lands. Payments are determined by the level (or tier) of participation, conservation activities completed, and acres enrolled. In FY2006, USDA spent \$259 million supporting 19,375 CSP contracts covering 15.8 million acres. Federal outlays for CSP activities have yet to be notified to the WTO; however, it is likely that CSP payments will be notified as Green Box-compliant environmental program payments under paragraph 12 of Annex II. Inclusion under paragraph 12 hinges on the payments being limited to the cost of expenses incurred or income forgone in implementing conservation practices. CSP cost-share payments fit this requirement. However, other CSP payments either made in excess of costs incurred or income forgone, or made in the nature of bonus or incentive payments to induce participation, are more difficult to classify.

The Conservation Reserve Program (CRP) compensates producers for removing environmentally sensitive, privately owned land from production for 10 years or more to conserve soil and water resources. The CRP is the federal government's largest conservation and private land retirement program. In FY2006, CRP outlays totaled \$1.8 billion and covered almost 37 million enrolled acres. CRP payments for the period 1996 through 2001 have been notified to the WTO as Green Box-compliant long-term resource retirement payments under paragraph 10 of Annex II. Inclusion under paragraph 10 hinges on the payments being used to retire land from marketable agricultural production for at least three years. Use of CRP land for agricultural production (e.g., cutting hay, grazing, or biomass production) potentially could disqualify the land from Green Box eligibility for that particular year; and potentially for all years of a long-term retirement contract if the productive activity is engaged in more frequently than once every four years. A potential alternative would be to reclassify the productive use of CRP land as a type of environmental program where payments would be subject to the criteria discussed under the CSP program. This report will be updated as events warrant.

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WTO Compliance Status of the Conservation Security Program (CSP) and the Conservation Reserve Program (CRP)

Introduction

This report provides a discussion of how well the Conservation Security Program (CSP) and the Conservation Reserve Program (CRP) comply with WTO Green Box rules. Specifically, some market watchers have questioned whether the current USDA implementation rules for CSP are consistent with paragraph 12 of Annex II of the Agriculture Agreement (AA). Also, questions have been raised about whether the allowance of harvesting hay and grazing on CRP land, as well as the proposed use of CRP land for biomass production, would be consistent with a reading of paragraph 10 of Annex II of the AA.

Both CSP and the CRP are likely to remain important policy tools in the next farm bill. Yet certain aspects of both programs potentially are ambiguous or fall into “gray” zones concerning their compliance with WTO rules. This report is not a legal opinion, but describes both the CSP and CRP programs, the WTO Annex II (so-called Green Box) provisions that govern compliance, and the potential issues involved in evaluating the compliance status of the two programs.

Conservation Security Program (CSP) Payments

The Conservation Security Program, authorized in the 2002 farm bill (P.L. 107-171), is a voluntary program that provides financial and technical assistance to promote conservation and improvement of natural resources on tribal and private working lands within selected watersheds.¹ CSP is administered by USDA’s Natural Resources Conservation Service (NRCS). Unlike the Conservation Reserve Program and some other NRCS programs, CSP provides payments for conservation on land that remains in production. NRCS implements CSP on a watershed basis in order to focus funding on high-priority areas that offer the greatest environmental impact per dollar spent. In FY2006, USDA spent \$259 million supporting 19,375 new and existing CSP contracts (4,400 new CSP contracts were added in FY2006) covering 15.8 million acres (an average outlay of about \$16.40 per acre).

Based on a review (done with technical support from NRCS) of a producer’s environmental resources and current conservation practices, each participating producer prepares a CSP contract including a stewardship plan that details the conservation activities that exist and/or are to be implemented. Contracts extend

¹ For more information, see CRS Report RS21740, *Conservation Security Program: Implementation and Current Issues*, by Tadlock Cowan.

from 5 to 10 years. By statute (Section 2001 of the 2002 farm bill, P.L.107-171), CSP participants qualify for one of three levels (or tiers) of participation, with each successive tier obligating the producer to meet a higher degree of resource management standards. Depending on the stewardship plan described in a CSP contract, participating producers may be eligible for four types of payments — stewardship or base payments; cost-share payments on existing practices; one-time new practice cost-share payments; and enhanced payments. These are defined as follows.

Stewardship or “Base” Payment. This is a payment tied to the number of acres enrolled in CSP. It is calculated separately for each land use by multiplying (1) the stewardship payment rate established for the watershed (based on 2001 national rental rates by land use category), times (2) the number of acres, times (3) the tier factor, times (4) the tier reduction factor (see **Table 1**). The reduction factor was not part of the authorizing legislation, but was implemented by USDA to provide a broader distribution of limited funding toward targeted activities and conservation benefits. In addition to the reduction factor, the stewardship payment is subject to an annual cap by tier.

Table 1. Stewardship Payment Formulation

Tier	Average land rental rate	Acres enrolled	Tier Factor	Reduction Factor
I	= (Payment rate)	x (# of acres)	x 0.05	x 0.25
II	= (Payment rate)	x (# of acres)	x 0.10	x 0.50
III	= (Payment rate)	x (# of acres)	x 0.15	x 0.75

Annual Cost-Share Payments for Existing Practices; One-Time Cost-Share Payment for New Practices. USDA and the participating producer each share a portion of the specific costs incurred or income forgone in meeting a particular tier’s contract obligations. The farm bill restricts payments for new and existing practices to not more than 75% of the practice cost (this rises to 90% for beginning farmers and ranchers). However, in practice, USDA has restricted payments to a substantially smaller share of implementation costs in an attempt to facilitate their calculation and minimize producer paperwork. For example, under FY2006 contracts, existing practice payments were calculated at a flat rate of 25% of the stewardship payment, and new practice payments were made at not more than 50% of the cost-share rate.

Enhancement Payments. Supplemental payments, called enhancement payments, are available for exceptional conservation effort and additional conservation practices or activities that provide increased resource benefits beyond those prescribed in the CSP contract. NRCS has stated that it seeks to base its enhancement payments on an objective measure of either adoption cost or environmental benefit; however, NRCS recognizes that it is not always possible to

quantify and monetize the benefits generated by environmental activities.² For FY2006, the enhancement payment was calculated with a variable payment rate for activities that were part of the benchmark inventory.

Total Combined Payments. The total of the stewardship, existing/new cost-share, and enhancement payments cannot exceed the following percentages of the unadjusted stewardship payment (which is based on average land rental rates): 15% for Tier I; 25% for Tier II; and 40% for Tier III. In addition to the percentage restriction, the total combined payment for a participant is subject to an annual dollar limit by tier.

Since its authorization in the 2002 farm bill, \$505.4 million of funding has been provided for CSP during the FY2003-FY2006 period.³ USDA has announced that it has no funding for new contracts in FY2007. As a result, CSP outlays in FY2007 will be limited to support for existing contracts and will likely be about the same as in FY2006. Most CSP spending is for cost-share payments. In FY2006, of the \$259 million in outlays, \$7.1 million was for stewardship payments and \$2.6 million was for enhancement payments, with the remainder for cost-share payments.

Relevant WTO Provisions for CSP Payments. The relevant language for notifying CSP payments as an environmental program in the WTO's AA, Annex II is paragraph 12.⁴

WTO, Agreement on Agriculture, Annex II, Paragraph 12.

12. Payments under environmental programs

(a) Eligibility for such payments shall be determined as part of a clearly-defined government environmental or conservation program and be dependent on the fulfilment of specific conditions under the government program, including conditions related to production methods or inputs.

(b) The amount of payment shall be limited to the extra costs or loss of income involved in complying with the government program.

General Discussion of CSP Payments and WTO Rules

Notifying CSP Payments. To the extent that CSP payments are in the form of reimbursement for a cost incurred or income forgone as described in paragraph 12(b) above, they clearly comply with WTO Green Box criteria. If, however, CSP payments are made in the form of bonus or incentive payments that exceed the costs

² "Interim Final Rule on the Conservation Security Program," *Federal Register*, Vol. 70, No. 57, March 25, 2005, pp. 15201-15223.

³ The total \$505.4 million was distributed as: FY2003 = \$3 million; FY2004 = \$41.4 million; FY2005 = \$202 million; and FY2006 = \$259 million.

⁴ The official legal text for the Agreement on Agriculture and its Annexes is available at [http://www.wto.org/english/docs_e/legal_e/14-ag_01_e.htm].

incurred or income forgone of implementing a particular conservation activity, then the “Green Box” compliance status of such payments could be called into question. Based on the way CSP payments are made, it appears that:

- cost-share payments fit “cleanly” into the paragraph 12(b) criteria of reimbursing for the extra costs or loss of income involved in complying with the CSP program;
- stewardship payments appear (at first glance) to have a “bonus or incentive” aspect in that they are simply based on participation (i.e., the number of acres enrolled and the level of participation by tier), thus making them questionable for the Green Box as environmental cost-share payments; and
- enhancement payments also fall into more of a gray zone in that they are described as sort of a “bonus” for exceeding contract practices, while it is unclear if they are limited in value to the often-difficult-to-measure added cost of implementing a higher level of environmental practice than otherwise called for in the contract.

However, two considerations are noteworthy. First, the combined effect of the both the tier and reduction factors as applied to the stewardship payments is to reduce them to a minor share of the 2001 average rental rate used — 1.25% for Tier I; 5% for Tier II; and 11.25% for Tier III. Since cost-share payments are limited to 75% of the practice cost (in actuality a much lower share is applied, as mentioned earlier), it appears unlikely that the combined value of the payments exceeds 100% of the WTO permissible cost-share value. Second, even the “bonus-like” nature of stewardship and enhancement payments could still be classified as Green Box eligible direct payments (rather than environmental payments) under the terms of paragraph 5 of Annex II, which allows for existing or new types of direct payments to be Green Box-eligible (i.e., to be exempt from amber box limits), provided they conform to criteria (b) through (e) in paragraph 6 in addition to the general criteria set out in paragraph 1, all of which are reprinted below.⁵

WTO, Agreement on Agriculture, Annex II, Paragraphs 1, 5, and 6.

1. Domestic support measures for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production. Accordingly, all measures for which exemption is claimed shall conform to the following basic criteria:

- (a) *the support in question shall be provided through a publicly-funded government program (including government revenue forgone) not involving transfers from consumers; and,*
- (b) *the support in question shall not have the effect of providing price support to producers;*

plus policy-specific criteria and conditions as set out [in paragraphs 2-13].

⁵ Ibid.

5. *Direct payments to producers*

Support provided through direct payments (or revenue forgone, including payments in kind) to producers for which exemption from reduction commitments is claimed shall meet the basic criteria set out in paragraph 1 above, plus specific criteria applying to individual types of direct payment as set out in paragraphs 6 through 13 below. Where exemption from reduction is claimed for any existing or new type of direct payment other than those specified in paragraphs 6 through 13, it shall conform to criteria (b) through (e) in paragraph 6, in addition to the general criteria set out in paragraph 1.

6. *Decoupled income support*

(a) *Eligibility for such payments shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period.*

(b) *The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.*

(c) *The amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.*

(d) *The amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period.*

(e) *No production shall be required in order to receive such payments.*

Since stewardship payments are linked to the number of acres enrolled in the CSP, they would appear, at first glance, to violate paragraph 6(d) — which states that payments may not be based on or related to a factor of production, such as land, currently in use. However, stewardship payments are essentially fixed at sign-up since both enrolled area and payment rate do not vary during the life of the contract — enrollment in a CSP contract is derived from production activities on previously farmed acres, and thus a base for participation is established (and fixed) at sign-up, while the payment rate is based on average 2001 land rental rates. As a result, stewardship payments could arguably be described as direct payments that fit paragraph 6(b)-(e).

Various policy analysts from both the European Union and United States have argued the merits of bonus-type conservation payments, suggesting that some incentive payment should be made WTO-legal since conservation activities have bona fide public good aspects and only minimally (if at all) distort trade, and without such bonus payments participation in conservation activities may be low.⁶ The WTO's Framework Agreement of August 2004 called for Doha Round negotiations to "review and clarify" the existing Green Box criteria.⁷ However, little discussion of Green Box criteria has taken place during the current Doha Round of WTO trade negotiations, and none of the Doha Round proposals includes any such provision to permit conservation bonus-type payments. It is unlikely that the Green Box will play a major part in a final Doha Round agreement should ongoing negotiations reach a successful conclusion.

The vulnerability to WTO challenge of such ambiguous bonus-type payments is probably highly correlated with the value of subsidy outlays. USDA programs in general tend to attract more attention and are subject to more international scrutiny when subsidy payments are large and arguably market-distorting. By traditional U.S. commodity program standards, CSP funding has been relatively small. During FY2000-FY2006, USDA's Commodity Credit Corporation net outlays for total farm support programs (including commodity and conservation programs) averaged nearly \$20 billion per year. In comparison, CSP funding during FY2003-FY2006 totaled \$505.4 million. Furthermore, because CSP payments are explicitly targeted to conservation practices, they are fairly benign in terms of their market effects; that is, they likely are minimally trade-distorting if at all. However, if CSP funding levels were to expand greatly to several billion dollars per year they could attract greater critical scrutiny. In its March 2007 baseline projections of USDA outlays, the Congressional Budget Office (CBO) projected CSP program outlays to increase steadily from \$259 million in FY2006 to \$769 million by FY2013.⁸

The Administration's farm bill proposal (released January 31, 2007) attempts to remove the payment ambiguity from the CSP program and make it fully WTO-compatible.⁹ USDA points out that some of the CSP payments, as currently structured, may be considered trade-distorting under WTO guidelines. To specifically address the WTO status issue, the Administration proposes removing the stewardship and cost-share payments, and replacing them with a single "enhancement payment," but basing the calculation of these enhancement payments "on factors such as income forgone by the producer and costs incurred by the producer to implement the ... conservation practices" as stated in its proposed legislative language:¹⁰

⁶For example, see "Should the Green Box be Modified?" by David Blandford and Timothy Josling, *IPC Discussion Paper*, International Food & Agriculture Trade Policy Council, March 2007; and "Should the Green Box be Modified?" by Charlotte Hebebrand, *IPC Policy Focus*, International Food & Agriculture Trade Policy Council, April 2007.

⁷Paragraph 16, Doha Work Programme, WTO, WT/L/579, August 2, 2004.

⁸CBO March 2007 Baseline, available at [<http://www.cbo.gov>]

⁹USDA 2007 Farm Bill Proposals, Title II: Conservation, legislative language; [http://www.usda.gov/wps/portal/ut/p/_s.7_0_A/7_0_1UH?navid=CONSERVATION_FB].

¹⁰Ibid., legislative language submitted in April 2007, p. 26.

“(1) CRITERIA FOR DETERMINING AMOUNT OF PAYMENTS.-

“(A) IN GENERAL.-The amount of a payment a producer would receive for performing either the progressive tier or master tier level of conservation practices shall be determined by the Secretary through rulemaking.

“(B) COSTS OF PRACTICES.-The Secretary shall establish the criteria for determining payment amounts under subparagraph (A) based on factors such as income forgone by the producer and costs incurred by the producer to implement the progressive tier or master tier level of conservation practices.”

Conservation Reserve Program (CRP) Land Use Issues

The Conservation Reserve Program, enacted in 1985, provides payments to farmers to take highly erodible or environmentally sensitive cropland out of production for ten years or more to conserve soil and water resources. It is the federal government’s largest private land retirement program.¹¹ In FY2006, CRP outlays totaled \$1.8 billion and covered almost 37 million enrolled acres (this amounts to about \$48.65 per acre on somewhat less than 10% of the nation’s cropland). The program is administered by USDA’s Farm Service Agency, with technical assistance provided by USDA’s Natural Resources Conservation Service.

USDA has notified the WTO of CRP outlays for the years 1996 through 2001 as Green Box-compliant under paragraph 10 of Annex II, which refers to long-term resource retirement programs. Inclusion of CRP payments under paragraph 10 hinges on payments being used to retire land from marketable agricultural production for at least three years. Use of the land for agricultural production would potentially disqualify the land from Green Box eligibility for that particular year; and potentially for all years of a CRP contract if the productive activity is engaged in more frequently than once every four years.

WTO, Agreement on Agriculture, Annex II, Paragraph 10.

10. Structural adjustment assistance provided through resource retirement programs

(a) Eligibility for such payments shall be determined by reference to clearly defined criteria in program designed to remove land or other resources, including livestock, from marketable agricultural production.

(b) Payments shall be conditional upon the retirement of land from marketable agricultural production for a minimum of three years, and in the case of livestock on its slaughter or definitive permanent disposal.

¹¹ For more information on CRP, see CRS Report RS21613, *Conservation Reserve Program: Status and Current Issues*, by Tadlock Cowan.

(c) Payments shall not require or specify any alternative use for such land or other resources which involves the production of marketable agricultural products.

(d) Payments shall not be related to either the type or quantity of production or to the prices, domestic or international, applying to production undertaken using the land or other resources remaining in production.

Agricultural Production on CRP Land. Section 2101 of the 2002 farm bill (P.L. 107-171) allows the Secretary of Agriculture to modify or waive a CRP contract in order to permit all or part of the land under contract to be used for the production of an agricultural commodity during a crop year:

“(2) PRODUCTION OF AGRICULTURAL COMMODITIES. — The Secretary may modify or waive a term or condition of a contract entered into under this subchapter in order to permit all or part of the land subject to such contract to be devoted to the production of an agricultural commodity during a crop year, subject to such conditions as the Secretary determines are appropriate.

“(d) TERMINATION. —

“(1) IN GENERAL. — The Secretary may terminate a contract entered into with an owner or operator under this subchapter if —

“(A) the owner or operator agrees to the termination; and

“(B) the Secretary determines that the termination would be in the public interest.

Since its inception, two types of agricultural production activity have been permitted on CRP land under certain conditions — harvesting hay and livestock grazing. Hunting privileges on CRP land also have been sold, but such action has not been treated as an agricultural production activity. In recent years, policymakers have eyed CRP land as a potential source for production of biomass feedstock for use in the production of bioenergy, such as biofuels or for the installation of wind turbines for the generation of electrical energy.

Harvesting Hay and Grazing. Harvesting hay and grazing have been permitted by the Secretary of Agriculture on CRP lands during periods of severe drought when commercial hay supplies have been either unavailable or prohibitively expensive and livestock managers have experienced extreme hardship maintaining their herds. While such productive activity might be interpreted as violating the conditions specified in AA, Annex II, paragraph 10, USDA has notified the entirety of its CRP subsidy outlays as Green Box resource retirement program payments during the 1996-2001 period. Section 2101 of the 2002 farm bill appears to have formalized the use of CRP land for harvesting hay and grazing during periods of drought and to offer a further possible exemption for harvesting of biomass or installation of wind turbines on CRP land by stating that a CRP participant shall agree to:

“(7) not conduct any harvesting or grazing, nor otherwise make commercial use of the forage on land that is subject to the contract... except that the Secretary (of Agriculture) may permit, consistent with the conservation of soil, water quality, and wildlife habitat —

(A) managed harvesting and grazing (including harvesting of biomass), except that in permitting managed harvesting and grazing, the Secretary —

“(i) shall, in coordination with the State technical committee —

“(I) develop appropriate vegetation management requirements; and

“(II) identify periods during which harvesting and grazing under this paragraph may be conducted;

“(ii) may permit harvesting and grazing or other commercial use of the forage on the land that is subject to the contract in response to a drought or other emergency; and

“(iii) shall, in the case of routine managed harvesting or grazing or harvesting or grazing conducted in response to a drought or other emergency, reduce the rental payment otherwise payable under the contract by an amount commensurate with the economic value of the activity;

“(B) the installation of wind turbines, except that in permitting the installation of wind turbines, the Secretary shall determine the number and location of wind turbines that may be installed, taking into account —

“(i) the location, size, and other physical characteristics of the land;

“(ii) the extent to which the land contains wildlife and wildlife habitat; and

“(iii) the purposes of the conservation reserve program under this subchapter; ...

WTO rules (paragraph 10, Annex II, AA) allow for no exception to the eligibility requirement that the land be removed from marketable agricultural production. As a result, the 2002 farm bill exception for harvesting hay and grazing on CRP land could be seen as violating paragraph 10.

Bioenergy Production. Generation of electric energy by wind turbines (whether installed on CRP land or not) is not regarded as an agricultural production activity by either USDA or the WTO. However, future commercial biomass harvesting on CRP land is likely to be considered an agricultural production activity. Recent strong interest in cellulosic ethanol production has spurred policymakers to consider the potential of the vast midwestern prairies (much of which is enrolled in the CRP) as a base for producing cellulosic biomass feedstock such as switchgrass or other native prairie grasses.¹² Biomass harvesting is likely to attract critical comment if it is done extensively (i.e., on a significant portion of CRP acreage) and if large subsidies support such activity. The high profile of such activity would only be enhanced if the result were to encourage either significant exports of U.S. biofuels or the continued use of a \$0.54 per gallon tariff import barrier on foreign biofuels.

¹² For more information, see CRS Report RL32712, *Agriculture-Based Renewable Energy Production*, by Randy Schnepf.

A potential alternative classification for use of CRP land for an agricultural production activity (e.g., harvesting hay, grazing, or biomass production) would be to reclassify the program activity from a long-term retirement program to an environmental program, where payments would be subject to the criteria of AA, Annex II, paragraph 12 as discussed under the CSP program.

Implications for Congress

Congress will be revisiting U.S. farm legislation this year and could potentially address the ambiguities concerning notification of CSP payments and agricultural uses on CRP land to the WTO. Such a tactic could potentially avoid or minimize the likelihood of future WTO challenges against U.S. conservation programs.